Company: **Gray Television, Inc.**

Conference Title: **Fourth Quarter 2016**

Moderator: **Dottie Boudreau**

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Operator: Good day, and welcome to the Gray Television Fourth Quarter 2016 Earnings call. Today's conference is being recorded. At this time, I would like to turn the conference over to Hilton Howell, Chairman, President and Chief Executive Officer. Please go ahead.

Hilton Howell: Thank you, operator. As she mentioned, I'm Hilton Howell, the Chairman and CEO of Gray Television. Thank you so much for joining us this afternoon for our fourth Quarter And Year-End 2016 Earnings Call. As usual, I am joined today by our Chief Legal and Development Officer, Kevin Latek, and our Chief Financial Officer, Jim Ryan. We will begin this afternoon with a disclaimer that Kevin will provide.

Kevin Latek: Thank you, Hilton. Good afternoon, everyone. Certain matters discussed in this call may include forward-looking statements regarding, among other things, future operating results. Those statements are subject to a number of risks and uncertainties. Actual results in the future could differ from those described in the forward-looking statements as a result of various important factors. Such factors have been set forth in the company's most recent reports filed with the SEC and included in today's earnings release. The company undertakes no obligation to update these forward-looking statements. Gray uses its website as a key source of company information. The website address is www.gray.tv. We will post both an audio recording and a transcript of this call on our website. We also will post an updated investor deck to the website in the next few days.

Included on the call will be a discussion of non-GAAP financial measures, and in particular, broadcast cash flow, broadcast cash flow less corporate expenses, operating cash flow, free cash flow, and certain leverage ratios. These metrics are not meant to replace GAAP measurements, but are provided as supplements to assist the public in their analysis and valuation of our company. We include reconciliations of the non-GAAP financial measures to the GAAP measures in our financial statements that are available on our website. And I will turn the microphone to Hilton.

Hilton Howell: Thank you, Kevin. We are extremely happy with the exciting and record fourth-quarter and entire 2016 results that Gray reported this morning. The breaking of $800 million in total revenue, with $1 billion clearly in sight, and $338 million in broadcast cash flow, is a very significant milestone for our company. As you may recall, we issued updated fourth quarter results in January when we announced the refinancing of our senior credit facilities. Today's earnings release confirms that our results met this previously issued guidance on both revenue and expense lines. Gray turned in another quarter, as we continue to build a larger, more diversified pure play broadcast company. In particular, Gray posted its highest-ever totals for revenue, net income and broadcast cash flow for both the fourth quarter and full-year 2016.

As the year ended, we entered the market to begin our first stock repurchases in several years. Specifically, we purchased 192,183, and shares in the fourth quarter at an average price of $10.38, for a total cost of $2 million. We close 2016 with total leverage ratios, net of all cash, of 5.06 times our trailing eight-quarter operating cash flow. This leverage ratio, when adjusted for the closing of the January station acquisitions, was 5.5 times, which is lower than the 5.7 times *pro forma* ratio that we had previously projected for year-end 2016. At the end of 2011, Gray had a trailing eight-quarter cash flow of a mere $117 million. Today, we have tripled the company's size, tripled the company's operating cash flows, and significantly reduced our net leverage ratio. We are very pleased with the progress we have made today, and we are committed to continuing these trends of growing our broadcasting scale, growing cash flow, reducing leverage and growing our shareholder returns over time.

By now, you know that Gray is not a company that moves slowly at any level. And accordingly, we have begun 2016 working strongly and feverishly on an ever-larger number of fronts. First in January, we completed the acquisitions of two number one ranked television stations from the former Media General. As you know, WBAY and KWQC are located within a cluster of similarly strong stations that we earned in the Midwest and Great Lakes area, from Iowa, Illinois, and Wisconsin, to Michigan, Indiana and Ohio. We also closed the previously announced acquisition of three stations in the Fairbanks, Alaska market, and the stations already are integrating nicely with our Anchorage television station, KTUU, which is the dominant television provider for nearly the entire State of Alaska.

Second, earlier this month we completed the refinancing of our revolving credit facility and term loan. This refinancing extended the maturities for the revolver and term loan to 2022 and 2024, respectively, without increasing our total indebtedness. In conjunction with last summer's and last fall's notes offerings, our balance sheet is now much stronger than it was just one year ago. In addition, our term loan, as amended, carries an annual interest rate of LIBOR plus 2.50% currently. However, given that our total leverage ratio equals 5.25 or less, the annual interest rate will decrease to LIBOR plus 2.25%. Third, we announced that we anticipate receiving proceeds from the FCC's Spectrum auction of nearly 91 million dollars. Kevin will address this accomplishment in his remarks later this afternoon.

Fourth, we very recently announced that we have reached an agreement with Diversified Communications to acquire its two Flamethrower television stations for $85 million. We could not be happier with this acquisition, because WABI in Bangalore, and WCJB in Gainesville are precisely the type of local stations that fit perfectly with the portfolio of top-ranked television stations that makes Gray so special. Each of WABI and WCJB consistently achieve number-one ratings in all major dayparts in their respective market, in both households and all key demos. Like many Gray stations, each of the stations can also boast that it has been the most-watched television station in its respective market throughout all of its weekday local news timeslots. We are very eager to welcome the employees and communities to the Gray corporate family. We are also grateful to the Hildred family for entrusting to us these wonderful institutions.

Just as we remain as busy as ever at Corporate, trying to build a larger, more efficient and more profitable Company, I can assure you that the managers, talent, sales staff and technology experts throughout our 54 markets are working equally hard. Last week we held our annual meetings of general managers and key corporate leaders. The tone across the board is one of real optimism. The mood in many of our markets, especially those in energy-dependent areas, seems much improved as we begin a new year with the potential for big changes in regulations, taxes and government policy. This enthusiasm is very encouraging.

In closing, I want to recognize the great work of our Washington DC News Bureau, which we launched just two years ago. Last year, the Bureau covered every presidential primary and general debate, every important state primary, both conventions, countless events and down-ticket races, and of course, election night. This year has been just as busy, with the inauguration, party retreats, special elections, executive orders, hearings and confirmations. And last night, the State of the Union address. Across it all, our Bureau covers local angles requested by the news directors at our local stations, rather than simply duplicating packages with a national or generic focus, that our stations can and do get from the networks. This approach has paid dividends many times over, as lawmakers understand they can speak directly with their local constituents by talking with our reporters right there in Washington DC.

On Monday night, our Washington Bureau Chief and anchors from WKYD in Lexington and WTBG in Toledo joined a small group of 15 other local television reporters for a private dinner at the White House with President Trump and his Chief of Staff and his press team, ahead of his speech to Congress. We were told that Gray was selected to join this first-ever dinner of its kind at the White House because of our company's commitment to local news.

Yesterday, our Washington bureau showed our deep local reach through coverage on Capitol Hill. The Bureau provided nearly 100 local interviews with House and Senate lawmakers, delivering our viewers both previews and reactions to the President's first joint address to Congress. Several of those interviews were conducted with heavy hitters, like Sen. Ted Cruz, Kentucky Sen. Rand Paul, and Virginia Sen. Tim Caine. We're very proud of the work of all of our talent and all of our professionals, not only in Washington, but across the country in each of our markets. This commitment to putting on the best local news products, at the end of every day, is the real key behind Gray's success. At this point, I will turn the call over to Kevin and Jim, and after their thoughts, we will open the line for questions. Kevin?

Kevin Latek: Good afternoon. With 2016 behind us, we can now afford many of new opportunities. First, as you know, we announce recently that we anticipated receiving $90,824,000 in proceeds from the FCC's reverse auction for broadcast Spectrum. Those of you who have been asking us over the past couple of years what the auction could mean for us, had heard repeatedly that we did not expect to receive any meaningful proceeds. Nevertheless, out of a true abundance of caution, we structured the acquisition on the former Media General stations in Green Bay and Davenport that we announced last summer and closed last month, with a possibility of receiving significant auction proceeds. Specifically, we acquired those stations as replacement property for the spectrum that will be relinquished to the auction, which in tax parlance means that we anticipate qualifying net acquisitions and the auction proceeds as a reverse-like-kind exchange. In this manner, we anticipate that we will be able to defer, on a long-term basis, any income taxes associated with the spectrum surrendered through the auction.

The end of the reverse auction and the quiet rule have led to more than a few new opportunities for Gray to acquire additional television stations. As you know, we had decided to acquire the Diversified television stations using the auction proceeds, which makes the acquisition of these very strong stations and their cash flows essentially leverage-neutral. We continue to evaluate other acquisition opportunities consistent with our previous commitment to consider prudent M&A and growth, without taking our eyes off the goal of deleveraging the balance sheet.

Like all of our peers, we expect the FCC will relax broadcast ownership restrictions over the next 12 to 18 months at both the national level and local level. We are supportive of any effort to reform antiquated regulatory rules that no longer serve the public interest. We welcome the FCC's new openness to consider how dramatically the news and media marketplaces have changed since the FCC last relaxed ownership rules, 17 years ago. As we have said many times before, we believe it is important for Gray to continue to grow the size and scale of our portfolio with high quality assets in a prudent manner, that permits us to achieve greater economies of scale, higher returns for our shareholders, and a more conservative balance sheet.

In other news, we have renewed several retransmission consent agreements that expired at year end, and most notably, Dish Network. We have one retransmit negotiation to complete, and we anticipate that it will be renewed in due course and privately. When that final deal is complete, we will have repriced roughly 4.6 million in-market Big Four subscribers, which represents roughly 40% of the 11.9 million in-market Big Four subscribers across all of our stations. We have the majority of our retransmission consent agreements expiring at the end of 2017. These contracts cover approximately 7,000,000 in-market Big Four subscribers, or 58%, at 11 million total. We will reprice the remaining 3% of the subscribers at the end of 2018. Again, note that these figures include all completed acquisitions, including specifically, Green Bay, Devonport and Fairbanks. These figures do not include the pending acquisition of new stations in Bangalore and Gainesville. On a combined and short basis, which again, includes the results of all recently acquired television stations, we posted to $221 million of gross revenue in 2016, and $113 million of net retransmission revenue.

As you know from our investor decks in prior calls, we have been estimating that 2017 would show growth over 2016 in both gross and net retransmission revenues, of about 17%, in part due to our conservative bias in estimating 2017 retransmission revenue, and in light of our success in the past few weeks with renewing a few large and important retransmission contracts, we can now raise these retransmission estimates for 2017. In particular, we anticipate that gross retransmission revenue will grow by 24% in 2017, over 2016, to $275 million. We expect net retransmission revenue will grow by almost 26% year-over-year to $142 million. For those of you doing the math, our net retransmission margin in 2016 was 51%, and we estimate that that margin will be the same in 2017. We have not refined our estimates for 2018 retransmission revenues at this time, and therefore, are not providing 2018 retransmission guidance today.

Thank you for the time, and I turn the call over to Jim Ryan.

James Ryan: Thank you, Kevin. Good afternoon, everybody. I'm going to keep my comments relatively brief, because, obviously, the earnings release, as well as the 10K that was filed a little bit earlier today, has got a wealth of information in it that is available for you to read. Following up on Hilton's comments about the refinancing in February, we were very pleased with that. That refinancing in the senior facility will save us approximately $4 million of interest per year, and as Hilton already mentioned, the revolver is now at $100 million, up from $60 million previously, with an expiration date of 2022. The term loan is due in 2024, and our notes issued from last year are 2024 and 2026. We have a very strong, very favorable debt structure in place.

Our total cash interest at current LIBOR rates is $85.6 million, which gives us a pre-tax blended interest rate of 4.8%. Thinking ahead to other large cash uses this year, in 2017 we expect our capital expenditures to be $32, on a high side, maybe $35 million. As we have said previously, in 17, we expect that the pay no material amount of state or federal income tax. We will have about 5.5 million dollars of required amortization on the term loan. Other than that, that's our cash uses prior to any voluntary debt repayments or other strategic uses of cash.

Turning to the guidance for Q1, and my comments are on a combined historical basis that will incorporate Green Bay, Devonport, and Fairbank, as if we had closed on them Sunday, 1st January. There's a couple of main drivers in the guidance. First of all, we've made some comments during the quarter that January got off to a slow start. The buy side seemed to take an extended Christmas break, and not really come back to business until a couple of weeks well into January. We knew all along we were going to have very tough comps in February, with the Super Bowl, last year it was on our CBS stations, this year was on our Fox stations. The CBS stations last year accounted for almost 4,000,000 households, the Fox stations this year accounted for a little over 400,000 households. We saw our Super Bowl revenues declined by 1.5 million. That's split roughly 1.1 million on the local side and 400,000 on the national side.

We're seeing in Q1 so far, what I would describe as a couple of key accounts that are reducing spending, or changing spending habits a little bit, which are driving our outlook for the quarter. First of all, in auto, we know Ford has taken some of their Tier 2 incentive money, dealer money, their co-op money, and moved what looks to be about $450,000 back to the national network or other uses. In communications, on the local side, we're seeing about $825,000 from a handful of what I would call midsized telco and/or MVPD accounts that have reduced spending. That looks to us like a lot of M&A-induced activity. We're also seeing, on the national side, another $400,000 in communications from a couple of accounts, just not being spent in our markets in Q1.

Continuing on, as we talked about several times last year, in the financial sector, American Home Family, that had been a very heavy spender with us in 2015, and then significantly reduced, and has basically eliminated spending in our market sizes in 2016. We've got some lag effect on that as well, and seeing another $300,000 on the national side. That was around first quarter last year, that just doesn't exist this year. They have completely changed their marketing strategy.

And finally, in the food category, again, we're seeing a couple of accounts that are shifting their dollars, at least for the time being, either back to national network and/or national cable networks, and that's creating about a $475,000 swing for us in Q1, and about a similar pattern on the local side, with about $275,000. While we would like to see Q1 a little bit better, especially in core, given the very hard comp we had with the Super Bowl and the current outlook being driven by just a handful of accounts, we're still remaining generally optimistic as we move through the rest of the year.

Turning very briefly to leverage, as we said earlier, netting all cash on hand at the end of the year, our trailing eight-quarter leverage ratio was 5.06. When we adjust that for the Green Bay, Devonport, Fairbanks acquisitions, that would be, on an allayed[?] basis, at the end of '16, about 5.5. And if you recall on our third-quarter call, we said that might – that adjusted ratio reflecting the acquisitions might be closer to 5.75. We are very pleased with what we've ended up '16 from a leverage standpoint. And again, with a very strong free cash flow generation of the company in '17, we look to continue to de-lever. As we said before, we expected to be in the lower fives by the end of this year on an allayed[?] basis, and well, well into the fours at the end of 18, on an allayed[?] basis. At this point, I will turn it back over to Hilton.

Hilton Howell: Thank you, Jim. At this time, operator, we will open up the lines for questions.

Operator: Thank you very much. If you would like to ask a question, please signal by pressing star one on your telephone keypad. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, press star one to ask a question. We will pause for just a question to allow everyone an opportunity to signal for questions. We will take a question from Marcy Rybaker from Wells Fargo. Please go ahead, your line is open.

Sae: Good afternoon, this is Sae filling in for Marcy. I have a quick question on the current pace of the business. I know you guys provided some color on Q1. Just wondering if you had a page number, and what your thoughts are on foreign, local and national for the year?

Kevin Latek: Well, again, as we said, we're generally optimistic for the whole year. I think national is [inaudible] – speaking for the whole year is probably flattish. Local, we would still expect on a four-year basis to be up low single digits, even though were up to a little bit slower start from Q1. Specific to Q2 business, that business is breaking very late. A lot of key accounts are only now just beginning to be negotiated, so we really don't have enough hard data points to make any comments on Q2. We certainly don't see in the late-breaking business any negatives at all, but it's just coming in later. It's actually the same thing we saw in January, it kind of started late for the quarter. And you've got our guidance in the release already for Q1, what we expect, locally and nationally, to do.

Sae: Got it. And in terms of leverage, where is your ideal leverage level, considering the M&A, and where do you think you guys will end up at the end of 2017?

Kevin Latek: Again, at the end of 2017 we would expect on an allayed[?] basis that our total leverage, net of all cash, will be in the low fives, and we're comfortable with that, and we would expect that it would be very far into the fours by the end of 2018, given the free cash flow generation of the company this year and next year. We ended this year on an adjusted basis, for the end of 16, an adjusted basis for Green Bay, Davenport and Fairbanks, at 5.5, which was actually a little lower than we had thought in our Q3 call, and we're pleased with that. We have always deliberately not set out a definitive range for leverage. We have said consistently for years that we want to prudently grow the company over time, while still watching leverage and, over time, de-levering. We have not set out a specific range. We understand that it's 5.5 to low five, going into the fours. We think we're in a good zone, and because we want to continue to grow prudently over time, we're not like some of our peers, that have been capped out recently and haven't been able to significantly reduce leverage, because they weren't able to grow.

Sae: Got it. Well, thank you very much,

Kevin Latek: Thank you.

Operator: We'll take our next question from Erin Watts from Deutsche Bank. Please go ahead.

Erin Watts: Hi, guys. Thanks. Jim, what – I know you were just touching on the leverage, but what was the main driver of you being able to finish off at a little less leverage than you had initially thought at the end of 2016?

James Ryan: I think it was really just the cash that we were able to accumulate a little bit, that was part of it. And then on an adjusted basis, a little bit was probably the two stations, the Green Bay and Devonport stations ended with a little bit stronger political. As you remember, that was constant rates turned high in the last couple of few weeks in the election cycle. And Davonport had done extremely well during the entire cycle, so there was a little bit of uplift from that as well.

Erin Watts: Got it. Okay. And as you move along those thoughts you provided on deleveraging over the next couple of years, do you see in that process some actual principals that pay down, or is that mainly through growth in the business?

James Ryan: That leverage assumes that we take the vast majority of our free cash flow and pay down debt over this year and next year.

Erin Watts: Okay, got it. Shifting gears, just a couple of questions on – thinking about the growing number of OTT and virtual MVPD offerings out there. How many of these news services at this point are you negotiating carriage with directly, versus the affiliate group, or your network partner acting as a proxy? And I guess, also, can you give us your latest thoughts around the economics of a streaming versus a traditional MVPD sub.

Kevin Latek: Hi, Erin. This is Kevin. We previously signed, and in 2016 we signed a few streaming agreements with the virtual MVPDs for some of our channels. We have yet to see them launch in our markets, because we are reaching out in mid-sized or smaller markets, so the effort thus far has been concentrated on larger markets. Overall, we have spoken with most of the folks who are reported to be interested in, or have launched their mobile VP, their virtual MVPD product directly, and our networks are also talking with those folks. I would say that, as you heard from other broadcasters, there is a very strong desire, not just by consumers, but by the folks who are doing these deals, to get local affiliates, and especially strong local affiliates. I don't think anybody forgets what happened to Direct and Dish when they got local affiliates added to their platforms. We were very interested in being there, we've done a couple of deals, we're not doing deals that don't make economic sense. We, I would say, our conversations have become more encouraging in the last couple of weeks, at least with some providers and some networks, we'll be able to get those deals done in the near term. We're not likely to be on every single OTT platform with every single one of our channels, because we're not prepared to be giving our signals away or subsidizing companies that are 10 or 20 times larger than us. We have a product that is in extremely high demand. I think our retransmission numbers that we announced today, again, confirm that. People will not have a business in most of our markets if they don't have our station on there. If the economics turned out to be appropriate, we will do the deals. If they intend to look for Gray Television to subsidize them, we will not do that deal.

Erin Watts: Okay. Now, that's helpful. And I'm positive, even though this is a bit mundane, just to clarify. As your deals are struck, if I'm going to subscribe to a new OTT service and I live in a Gray market, where you are the CBS affiliate, if you don't have a deal with the new provider, am I able to stream CBS content, even if it's a not local, or am I totally cut off from that?

Kevin Latek: If you live in a Gray market and have signed up for an OTT provider that we do not have a deal with, you do not have the ability to watch a CBS TV station owned by anybody. You either get our local signal or you get no local, so you get no CBS TV station.

Erin Watts: Perfect. Thank you very much.

Kevin Latek: Certainly.

Operator: We'll take our next question from Dan Kernaust from the Benchmarks Company. Please go ahead.

Dan Kernaust: Yeah, thanks, good afternoon. Obviously, M&A being at the forefront today, with some of the news items out there. You guys obviously have had a pretty consistent strategy on the net buyer side, and it doesn't sound like that's changing, even with a lot of commentary around UHS discounts, and maybe even cap rates later this year. As your peers come down and start to scale back up, can you maybe give us your thoughts on either potential station swaps? I know you guys are in smaller markets. Maybe it's harder. And since the JSA rule also seems to have been rescinded, any thoughts on pressing that channel?

Kevin Latek: Dan, the JSA rule is not rescinded. The FCC rescinded the public notice that the FCC issued in March 2014 that said that if you are selling a TV station – if you are intending to buy a TV station that has a JSA, and you have any financial component between the JSA station and the broker station, the application would be subject to additional scrutiny, whatever that happened to mean. If you have a JSA, we cannot go out and create a new JSA. That rule was not – the JSA ban is still on the books, it is still enforced, it is simply a question of processing guidelines, how much scrutiny does your application get if you have a JSA and a financial component in NDO.

The larger question is, where are we with the M&A in light of today's headlines, I'd say the same thing I said in remarks, that we've said consistently. We have been generally opportunistic and generally patient with growing the company, although I guess in the last couple of years we've moved pretty quickly in that regard. We're going to look to continue to grow the company in ways that make sense to our shareholders. Station swaps, they don't really seem to make any sense for us. We're very, very happy with the stations that we have in the portfolio that we've built. I would expect that if some of the other folks – if pretty much anybody else gets together, any large transactions, there will be market overlaps that, regardless of FCC rules, changes will require divestitures, and those divestitures may create opportunities for us. While we may not participate in two large companies getting together to form a super-company, we may well be there to pick up some good assets, or great assets, just as we did last time when Media General got together and we were able to pick up the really good stations in Green Bay and Davenport. I think it means – I think what this new round of consolidation, post-auction and new FCC outlook creates opportunities for us in a lot of ways, but there is not – we're not looking to start swapping with folks to create a different kind of portfolio.

Dan Kernaust: Got it. That's helpful. Then, just in terms of [inaudible]. Obviously, you guys can start ruling that out. Our understanding is that in the repack, you may be able to get reimbursed from shift from 1.0 to 3.0. Can you tell us how you think about divestment in 3.0 and the timing of that as it gets rolled out, and eventually, finally approved by FCC?

Kevin Latek: Sure. It's our understanding that we will not be able to buy broadcast transmission equipment without the equipment being 3.0 compatible. Whether we believe in it or not, as we go through the repack in a number of stations, we will be getting new transmission equipment that will, by default, have 3.0 capability. Which is a very good thing for all of us in the industry. Overall, we have been big supporters of 3.0 and the work that Sinclair and ATC has been doing. We are, at this point, not expecting to rollout or convert any station to 3.0 this year. We are expecting that a business case will be developed first in the larger markets, to justify the rollout in the largest markets, and as we saw with DTV and HDTV and HDTV for news, gear, etc., the cost will come down as time goes on and more markets transition.

3.0 presents some interesting opportunities for us, especially the bandwidth throughput, but again, we need to see a little more of a business case, and I don't think anybody at Gray is expecting that we're going to have any transitions in 17, and it's too early to say whether there might be some markets that would be ready and can justify the cost of transitioning in early 18. We're going to continue to be close to it. We try to attend and participate in all of the conversations around ATC 3.0 that we can, to be as smart as we can, but given the size of our markets and the initial cost, there is not going to be a 3.0 rollout at Gray Television this year.

Dan Kernaust: Great. That's super helpful, Kevin. I just have one last one, and I'm not really sure how to ask this, but I'll try to dance around it a little bit. It's on the retransmission front. I know you guys haven't been overly aggressive historically. You still got blacked out on Dish and then still had upside to your retransmission. I think we're trying to gauge, as we try to gauge a team, I guess, anyway, any incremental color, or general optimism that we can glean as we head into '18 with the majority of your footprint coming out, would be helpful. Thanks.

Kevin Latek: Sure. I guess I'm delighted to hear that anybody thinks that we're not aggressive in retransmission, because I think that every MVPD declares us to be Darth Vader in terms of our price expectations. Frankly, we're proud of the fact that we don't really come off on one little operator for less than 24 hours two years ago, a larger operator in three markets for about six days, and that's it. There are no other blackouts in Gray's history. Part of it is because were patient, and as we've said a couple of times, we've had a bunch of deals that reprice on Sunday, 1st January. We don't believe in set deadlines, and we will continue to grant extensions if we think the conversations are going in the right way, with the prices being retroactive to Sunday, 1st January.

In terms of whether we're asking for enough or not, I can't answer that question. What I have seen from the third-party research, and you can probably do the math yourself, our personal rate is at the high end of this industry, and I don't think we will be able to boast that if we did not have high-quality stations, and we were not being aggressive. If you look at the chart of our retransmission, starting about five years ago, we've gotten much more aggressive on retransmission, because we had to. And for some other reasons, mainly that I was doing them, we just pushed a lot harder.

I think looking into '18, you should certainly assume that we will post higher numbers in '18 and '17, we just did 40% of our subbase, we have almost 58% up next year. That's a large number of providers, and obviously, a large group of our subs that have to get repriced on Sunday, 1st January. We can't give a guess yet as to what those numbers look like, but it's certainly going to be higher on the gross and net side than it is for '17, just, one, because of the escalators in the contracts we just signed, and secondly, because there's just so many contracts that are up next year.

Dan Kernaust: Thanks, Kevin. And I guess, just a quick follow-up on that. Do you think that given the large numbers of providers that are coming up, that we could see a pattern to what we saw this year where some of them, as you just said, some of those might get extended past Sunday, 1st January and retroactive, so it might not be even keel once we start there?

Kevin Latek: Our prices are always going to be retroactive to Sunday, 1st January, just out the fact that there are so few people here at Gray to do these retransmission negotiations, and there are several hundred of them that happen to come due on Sunday, 31st December 2017. There will absolutely be deals that will not get done until January, and maybe even a couple that roll into February. And that's not unusual for broadcasters, it's not unusual for us. Some broadcasters might start a little earlier than us, so they can finish up by Sunday, 31st December. We tend not to start all that early. We'd rather have more people go out before us than – And we've, again, got basically two people in the company negotiating all of these big deals, and have a lot of other things to do at the year end and the beginning of the year, and sometimes we even go away for

New Year's Eve. There will certainly be stuff that rolls off into January and February, but the prices will be retroactive in Sunday, 1st January 2017.

Dan Kernaust: Perfect. Thanks, Kevin, for all the color. I appreciate it.

Kevin Latek: Certainly.

Operator: Our next question comes from Kyle Evans from Stevens. Please go ahead.

Kyle Evans: Hi. Thanks. Jim, I know we've kind of beat the leverage horse, I'm going to hit it again, though. What is the upper limit of your covenants as they stand today, and how much dry powder do you have in the event that something irresistible, that may be a little bit larger than diversified, comes along?

James Ryan: The senior credit facility in both of our notes issues have a seven times incurrence test on an allayed[?] basis for all-in debt. Our senior facility also has a 4.25 times maintenance test on first-lien only, and only when and if the revolver is drawn. And then there is a general first-lien basket, or I should say, secured debt basket, whether it's first or any other kind of secured debt, which is more flexible than the revolver test. It would be fair to say that the theoretical capacity of our debt agreements gives us a tremendous amount of capacity, and without putting a number on anything, probably, it's certainly probably more capacity than we could prudently use.

Kyle Evans: Okay. I'm going to let you get away with that, but the dollar sign on it. What is the auto assumption that you have built into your 1Q and your '17 outlook?

James Ryan: Auto is down a little bit in Q1. Again, I know we've got $450,000 or so of Ford money that shifted away, they just took it out of the Tier 2 spend and the factory took it back to do whatever with it. Also, Auto is down a little bit year-to-year too. I don't have the specific breakdown, but in that 1.1 million local side Olympic dip, there would've been a reasonable amount of auto guys in there, on – I'm sorry, Super Bowl, there would've been a reasonable number of guys in that Super Bowl number as well.

Kyle Evans: Okay. And, Kevin, I know the OTT question has been asked, but I was biting my fingernails over the YouTube launch. They launched, and basically aren't going to sell it in markets where they don't have linear network. Do you view that – was that as expected, better than expected, immaterial? What's your kind of high-level thinking on the YouTube product?

Kevin Latek: In our conversations with the folks at YouTube, they could not be more clear that they want the affiliates. Again, we have a real-world example with DirecTV and Dish 15 years ago. They are targeting a millennial audience, for the most part, the millennial audience tends to dovetail with places where you have lots of colleges and universities, which tends to, frankly, not be oh-no markets, outside of maybe, Boston, San Francisco. Those are markets in which the affiliates have the local stations. They've been very, very clear to us that they want to have us, they've been very open to working with us, and with other broadcast groups, to come to terms that make sense for everybody, and we hope that we will be able to get our stations on YouTube for the near term. But there's nothing that's going to be announced in the next two weeks, that's for sure. We're working on it.

Kyle Evans: Is there a mechanism that you can see where YouTube or any other of the OTT players can apply pressure to the networks to make them do what's right by their affiliates, or is it just kind of a wait-and-see game?

Kevin Latek: We were not in the room when the networks negotiated their deals with the OTT providers last year. We're not in the room with them now. We can only assume that the affiliates, that the OTT providers that really want something, and have not been able to get it from the networks, have made it clear to the networks that their desire for the affiliates, that they have made abundantly clear last year, is even stronger now that they are trying to get to market. We would assume that they have conveyed the message that you said, but we're obviously not privy to any of those conversations.

Kyle Evans: Okay, thank you.

Kevin Latek: Sure.

Operator: We'll take our next question from Jim Goss from Barrington Research. Please go ahead.

Jim Goss: Thanks. A couple of others on M&A. Would you have any interest in sliding either up or down in terms of market size in any of the additional M&A as you've filled up the dance card on the air markets you're in? With the availability of, maybe, some of the OTT options, make the slightly larger market somewhat more interesting? And I've got a couple of others.

Hilton Howell: Jim, I'll start, and then I'll let Kevin follow up with that. The answer is yes. I think our group of TV stations, and the professionals that run our group and our stations, know how to run a TV station, know how to run it well, and there's not a tremendous amount of difference between our largest market, which under the current DMA is Knoxville, and a lot of markets that are a lot larger than where we currently are. Gray has not looked at market size per se, we've looked at market dominance and profitability of television stations as a key guidance of where we were going together. But we're not – we would never say that we would not go into markets larger than we are now. We have accumulated a great number, in the mid-and small market areas, and we would be interested in getting into larger markets, if and when they become available, and if and when they fit our generally universally news-centered universe of stations.

Kevin Latek: I would echo what Hilton said. We have a lot of small-market stations. The mid-market stations are certainly more interesting to us financially, they're generally better for us and we seem to have a fair amount of success with mid-market stations, and we'd like to have more of those. But we don't think that just because we've done well with some mid-market stations, that there aren't markets larger than Knoxville, which is currently our larger market, that would not also be good stations for us in terms of margin, in terms of what they can do for the overall portfolio. I'm not sure I understand the OTT piece.

Jim Goss: Just to the extent that there might be some additional business. You just alluded to the fact that they don't tend to be in the interest in the very smallest markets, and maybe some that might give more relevance to that, in a companion piece of business.

Kevin Latek: Yeah, I mean, look, in the best-case scenario, to the OTT subs across every provider, across every market, currently it's less than 1 million out of 100 million homes. That's not very exciting. It's not even a rounding error. They could double their success and triple their success, and there's still at ridiculously small numbers, and they're still going to be concentrated in top ten DMA. At some point OTT's overall, and the smaller markets, especially, if the technology for both the broadcasters and the OTT allow them to scale smaller markets, without additional costs, without exceptionally additional costs. But it's never getting – it won't, for several years, OTT revenues will not be meaningful to, I think, anybody, potentially. Maybe the guys in the largest markets, but there's just, there are not – if you look at the households, they just drop off quickly once you get outside the top-tier markets, it drops like a stone. If we have OTT penetration in urban markets, which should be higher than non-urban markets, you can expect that bigger markets are going to have most of the OTT subs. Us simply getting into the DMAs for the 30 to 50, is not going to employ any real OTT dollars in our bottom line.

Jim Goss: Okay. Maybe I'll just ask Ryan one other. Sort of a post-mortem on the presidential race. In the wake of Trump and Clinton, and what that did to some of the national election, was he unique due to his public profile, or given that Clinton also spent less, does this become more of the trend? Have the national committees decided maybe their social media ways and advertising ways to reach audiences, at the very least, 2020 is likely to be impacted. But does this have any impact, do you think, on some of the way you look at presidential spending?

Hilton Howell: We do not. Candidly, Jim, we think that 2016 was a very unusual aberration. Gray accumulated a tremendous amount of political through the course of the year, not as much as we had in previous presidential elections on a *pro forma* basis. But if you just look at the Hillary Clinton campaign, in the markets that we're still heavily in, in the Midwest and the Great Lakes area, for instance, she basically felt like she owned and had those markets, and consequently, lack of her spending. I don't think any Democratic nominee will ever take those states for granted again.

I think the Trump campaign is a unique and special black-swan event. He began with name notoriety, that was essentially 100% throughout the country, due to being on television for 13 or 14 years in a top-rated television show. He had a unique ability to communicate, and did so, and I think that we – it is highly unlikely that we will see presidential candidates in the future with his level of notoriety and name recognition. We actually are looking at 2018 as being a really huge political year, not only at the senatorial and gubernatorial, but also the Congressional level across the board. We are very optimistic about political.

Hilton Howell: Jim, if I can just add briefly, part of why they, to me, the Clinton campaign did not compete as much on air or otherwise, what was because of who the opponent was. I can't recall one Saturday Night Live has done such a thorough job of marking a candidate, and just the mere assumption that he might win was a punchline in and of itself. In Trump gathered enormous free media, not because he was a celebrity, he was on television for 13 years with a reality show, he gained public media because when he had been a celebrity, going back to the 80s, to my knowledge, he's the only guy I've ever seen do a cameo in the Home Alone series, and I was a kid one that was on TV and when that was on theaters. There is nobody who is a celebrity in the 80s who's in the tabloid pages that I can think of, maybe besides really Madonna, who hasn't already passed away. And it's that commentary, I don't mean to be cryptic here, but there just aren't that many celebrities from the 80s who were celebrities throughout the 90s, throughout the 2000's, still around.

Add on top of that the fact that the media coverage he got was not because he was a high-profile media person, a well-known person running for office, it was because he said things that were shocking to the media, and the media coverage was very generally not positive at all. They were all over him because every day or so, there would be something that generated a lot of media coverage. We can take the most famous person in the world, whoever that is right now, and I don't think they would get as much press as Donald Trump did, because they won't say the kind of things that he said, or tweet the kind of things that he did. It was a shock-and-awe campaign that he did, that provided so much free media. It's hard to imagine that there is anybody out there who would be as shocking and as awful after decades of being famous.

It led to him not spending, and it led to Clinton not thinking she needed to spend, and suddenly in our conversations, the media buyers, I'm not sure anybody in the media buying business think that Facebook can change a vote. TV ads change votes, Facebook is good at name recognition, getting calls to action from people who already believe in your cause. They do not change votes. And that's what we're selling, we're selling an ad medium that creates demand for cars, and Pampers, and vacations, and insurance products and political votes. We're in the right business, and 18 and 20, I don't think they're going to be as subdued as we have seen in 16.

James Ryan: He might've been right about the liberal bias of the media, but it came to accrue to his benefit. Because they targeted him. Anyway, thank you.

Jim Goss: Thank you, Jim.

Operator: We'll take our next question from Leo Culps, from RBC Capital Markets. Please go ahead.

Leo Culps: Hi. Thanks for taking my questions. First, on your broadcast expenses for 2017. I think your combined historical level was $490 million. In 16, you gave some guidance around reverse comp. How should we think about gross and expenses as reverse comp in 2017? My second question is, what is your position on Gray potentially being a seller? What sort of price do you think would be reasonable? Is there anything you can tell us how to figure out how you guys might approach a sale of Gray, if another group were to buy it?

Hilton Howell: Well, Leo, we're not looking to sell Gray. I'm sure somewhere there's a price that our Board would consider, but it would be an awfully high price. We think we have a unique and special broadcasting property and a unique and special business. We're looking to buy, not to sell.

James Ryan: Leo, going to the '17 expense numbers, as you can tell in our Q1 guidance, if you take out the reverse comp, it's up about 6.5 million, give or take. Really, the expense line is basically flat on a combined historical basis. And as we run out for a full year, it's probably not a whole lot different than that. You can back into– the reverse comp is going up, but that's going to explain the vast majority of any expense increases, and absent the reverse comp, you're talking in what could very well be in the single millions of dollars of overall increase, which is going to be a pretty small percentage.

Leo Culps: Got it. Thank you both.

Operator: Our next question comes from David Tabair. Please go ahead.

David Tabair: Good afternoon. Thanks for taking the questions and fitting me in. I appreciate it. Jim, just for housekeeping. What is LTM *pro forma* EBITDA, so we can count leverage from that perspective?

Hilton Howell: Give me half a second, and I can look that up for you.

David Tabair: Thanks. While you're looking that up, I just wanted to confirm that the leverage metrics you gave does include the impact of Diversified.

James Ryan: That is correct. It did not include the Diversified, or the auction proceeds, but that's – we recycle the auction proceeds, for all intents and purposes for Diversified, so that's kind of, as Kevin said, it's basically neutral. On a key-12 basis, operating cash flow would be defined in the credit agreements, at December 16, was $312.6.

David Tabair: Okay. Thank you, and I'll just try to ask one more, in the interest of time, and sorry that it's another M&A question, but I know there's still a lot of fragmentation on the lower end of the TP household reach spectrum, more diversified kind of companies out there. I'm just curious, after the auction, now that that has sunset, is there a higher motivation for them to look to sell? And if so, how would you compare Gray's retransmission rates to some of these smaller groups? Is there still a meaningful retransmission synergy opportunity?

Kevin Latek: This is Kevin. I think the auction has certainly unfrozen some transactions, but it's primarily not people that would have stations that we would want to buy those, or typically not the people that would be expected to sell in any auction, it's a lot of second stations or secondary stations, not the number-one ranked stations, as a general rule, that file the auction applications. What really has helped things more so, we believe, was the election. We typically buy from multi-generational family owned stations, and those folks tend to sell an odd number of years, not an even number of years.

It's the conflicts of both of those that I would think is leading to more folks thinking about selling. As more people sell, or as more possible deals get announced, it starts to focus the mind on owners that maybe it's time to sell, because there's so much activity happening around them, and they don't want to get left behind. The FCC relaxing the ownership rules is also another spur. We've gone through several wildernesses last year, where Gray announced, we announced Fairbanks, we announced Clarksburg, we announced Media General, and almost a whole universe of deals that were notified last year, to this year being quite the opposite of that, 180° opposite of that. There are certainly going to be a lot more stations and groups offered for sale, and we think, big market, small markets, great stations, not so great stations, things we'd love to buy, things that probably Gray itself would not look at. It's going to be a very interesting next 12 or 18 months.

To your second question, the retransmission that we have seen in diligence suggests that we have a significant advantage in retransmission, because we're not just negotiating for a really dominant station in a mid-sized market, that Dish Network couldn't care less if they lost subscribers in one market with a couple of hundred thousand homes, and just a fraction of them being their subscribers. When we can talk to an MVPD about having 13 dominant stations, or 20 dominant stations, or 54 number one stations, it changes the calculus for them. We think we've been able to, despite the fact that we been able to cover only 10% of the country, not 39% of the country, to obtain retransmission rates that are at the leading edge of the business. There is still a great deal of ways for us to go. We still think we're getting only a fraction of the value that we actually provide to folks who are selling video packages, and over time, that we will continue to close that gap.

At this point in time, I would say that the bigger broadcast groups, and I would include us in that,, have been able to achieve retransmission rates that are meaningfully higher than folks who are only operating in one, two, three, four or 10 markets. Even if they've got very, very good stations and they are very smart people, it's just a difference of leverage. And for us, frankly, it's very different in what we can tolerate versus what other folks can. For example, there's a station, a dominant station that we've acquired in the not-too-distant past, and a dominant cable operator in the market, who had, frankly, gotten some pretty good rates out of that broadcaster, because that broadcaster was only in that market, and relied on that cable operator to deliver three quarters or more of their eyeballs, and could not afford to be off for an extended period of time. We flip the tables around for us, that's less than 1% of our eyeballs. If worst came to worst, and we were off the cable operator for two or three months, it wouldn't matter to Gray Television Inc. In that context, that negotiated conversation is completely different one Gray is negotiating on behalf of that dominant station than to form their own, even though, again, they were good people, who knew what they were doing, they just could not suffer the idea of being off of that cable system for more than a couple of weeks, whereas we certainly can't.

David Tabair: Very interesting.

Kevin Latek: Does that answer your question?

David Tabair: Yes, it does. Thanks, Kevin. Thanks, Jim. Thanks, Hilton.

Operator: We'll take our next question from Barry Lucas, from Cabelli and Company. Please go ahead.

Barry Lucas: Thanks very much for fitting me in. I'll keep it to one. Hilton, I really appreciate your comments on share repurchases. I was hoping that maybe you could provide a little bit of color on the calculus that goes into the decision, when you're in the market are not. Where does that fit in versus M&A or other things you could do with cash?

Kevin Latek: It's relatively an opportunistic sort of situation. We dropped down a little bit in the fourth quarter, and when we stepped out to support our stock price, and when we see weaknesses, we'll take a look and will weigh that against the use of our proceeds. And we just look at it day-to-day.

Barry Lucas: Great, thank you for that.

Kevin Latek: All right. Thank you, Barry.

Operator: Our next question comes from Brian Hirschfeld from Baine Capital Credit. Please go ahead.

David: Hey, guys. Thanks for taking my questions. This is David, on for Brian. I just start coming back to your answer to Erin's question on OTT. Did you mean that in your CBS markets, where you don't have a deal with virtual MVPD's, that subscribers can't get another CBS station, or is it that they can't get CBS network content at all, like prime time and NFL?

James Ryan: Let's set NFL aside, because they have different restrictions based on different screen sizes on providers and whatnot. Our exclusivity is against other CBS TV stations, including the network ONO. If our Knoxville station is not carried by an OTT provider in Knoxville, that provider cannot bring in another CBS TV station and give that to customers in our market. CBS, however, does have other programming delivery mechanism, and one of them is VoD. They can play, generally, network entertainment content, I think it's 24 or so hours after it's live broadcast. If you want to watch the CBS station, especially if you have other TV channels, linear TV channels available on your line-up, and you're flipping through, there will be a black screen or no screen at all for CBS. If you then click over to the VOD box of window drop-down, however you access it, you can find a CBS program and pull it out, you can see past episodes, and it depends on-CBS is a different deal about what VoD is available after how much time it's held back. You can certainly get the content, but not in a user-friendly way, so it's not a good user experience.

Brian Hirschfeld: Okay, thanks.

James Ryan: Sure.

Operator: There are no further telephone questions. I would like to turn the call back over to Mr. Howell.

Kevin Latek: Before Hilton says anything, I just wanted to say we appreciate – we notice a lot of questions and commentary on OTT and retransmission. It seems they're increasing with every call. We, frankly think it's a sign of years of mystification with this complex area, and the answers are going to continue to be different on the OTT space, probably in every call and every quarter. I appreciate your patience with us, and understand we're not trying to be too glib and dismissing OTT in that they have no substantive market. There will be a business there. It's just not there today, and were just not going to rush quickly to doing bad economic deals. I certainly appreciate everyone's patience with us on OTT dales, and now I'll turn the call to Hilton.

Hilton Howell: Thank all of you for all of your questions. We thank you for joining us today, and we look forward to speaking with each of you next quarter. Thank you.

Operator: This concludes today's conference. Thank you for your participation. You may now disconnect.